ENERGY TRANSITION: BALANCING THE INTERESTS OF INVESTORS AND STATES ON THE PATH TO CLEAN ENERGY

197 Governments (and the European Union) have ratified or acceded to the Paris Agreement, pledging to pursue efforts to limit the global temperature rise to 1.5°C above preindustrial levels. To meet the 1.5°C target, international action will have to bring about a clean energy transition that is unprecedented in scale and opportunity.

As we move towards the clean energy sources that are required to mitigate the climate emergency, vast investment will be needed. Therefore, it is crucial that those States most in need of inbound investment to power their energy transition can access the finance flows they require. With developing countries currently hardest hit by the effects of climate change, the investment protection framework can play a key role in facilitating the process of change.

Under the international framework of bilateral and multilateral treaties, an investor from one State may bring a dispute against another State in which it has invested, invoking international protections where it deems its investment to have been harmed. Investors may be from across the whole of the value chain, including extraction, distribution and combustion as well as financial investors holding direct or indirect, majority or minority stakes in operating companies.

The existing framework of investment protection treaties – comprising almost 2,600 bilateral and multilateral treaties – largely predates the climate emergency. Typical bilateral investment treaties provide for broad protections for private investments but make no distinction between fossil fuel and renewables investments. With the scope of protections offered varying across treaties, investors need to obtain certainty as to the level of protection they can expect, before committing to further long-term substantial investment.

Some States are starting to reconsider the investment protection framework offered to investors in their investment treaties in light of their Paris Agreement obligations. The lack of differentiation in the level of protection provided to fossil fuel and clean energy investments has led to a tension between (i) States seeking to phase out fossil fuels in favour of an increased use of renewable energy, and (ii) investors at the same time seeking to rely on broad protections granted by States that, in the investor's view, also apply to their fossil fuel investments, which have often been costly and based on long-term planning.

This tension has played out, for example, in the high-profile cases of *RWE v Netherlands*, in which RWE is challenging the Netherlands' planned phaseout of coal power by 2030, and *Rockhopper v Italy*, in which Italy was held liable to pay damages for amending its regulatory regime to halt coastal oil exploration. These cases highlight how the provision of legal stability to induce capital-exporting States to invest in capital-importing States (such stability being crucial to underpin the energy transition) has collided with the obligation of States to transition away from fossil fuels and towards clean energy.

States are also rethinking the incentive regimes that they have already granted to investors in renewable energy, in circumstances where they are being forced to rapidly adapt their energy transition policies due to sudden macroeconomic changes. This can stem from a number of issues, including cost and availability of technology and renewable energy capacity limits. Again, a tension arises between (i) the need for the State to adjust its own renewable energy generation policies and (ii) the investor's rights as granted under existing incentive schemes. Waves of cases (most notably against Spain and Italy) have resulted from changes made to renewable energy regimes. More broadly, energy claims are also pending against various non-EU States, including Albania, Japan, Peru, Mexico, and Sri Lanka.

A key agreement in many of these disputes is the Energy Charter Treaty (ECT), which also does not distinguish between fossil fuels and renewables in the scope of its protection (nor does it mention any right to regulate for the purposes of environmental protection). Discussions remain ongoing within an initiative to reform the ECT. However, some States have announced plans to withdraw from the ECT outright, arguing that it does not go far enough to address their climate change obligations.

This ongoing uncertainty gives rise to risk for both investors and States. As the investment protection regime responds to the competing tensions of the climate emergency, we expect a number of shifts to take place on both sides. States are likely to seek to reform their treaty obligations to ensure that they strike a balance between offering a sufficient degree of legal protection so as to attract the investment needed to drive renewables, while still retaining the right to regulate in order to move towards clean energy. This may mean renegotiating treaties in order to, for example, remove fossil fuels from the scope of applicable protections, and/or introduce exceptions to applicable protections for State regulation in the interests of environmental protection and the energy transition. This is the case for example with the Colombian Model BIT, which includes a general exception for protection of the environment; similarly, the Morocco-Nigeria BIT requires investors to "comply with environmental assessment screening and assessment processes". Ultimately, as protections for fossil fuel investments wane, investors are likely to shift their focus to sustainable, environmentally friendly investments and the new clean energy technologies required to drive the energy transition.

Our finance, corporate and dispute resolution teams at Clifford Chance are well-placed to support the energy transition from both the investor and the State perspective, as well as provide representation and advice from all angles through our specialist investor-State arbitration team. Our full suite of advisory capabilities means that we can assist at every step of this process, including supporting investors in (i) planning their projects prior to investing, treaty structuring, risk analysis, and political risk insurance, and (ii) navigating this fast-shifting investment protection terrain. On the State side, we can help States to review and amend their treaty obligations as well as review policies for compliance with existing investment treaty obligations, to ensure they craft their international obligations in such a manner that (i) provides comfort to investors, whilst (ii) maintaining their desired scope of regulatory powers in the face of the climate emergency.

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